

## ALTERNATIVE FORECASTS

DRI has assigned a 55% probability of occurrence to its June 2000 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP expands by 4.9% in 2000, 3.0% in 2001, 3.1% in 2002, and 3.5% in 2003;
- U.S. nonfarm employment grows 2.3% this year, 1.5% next year, 1.0% in 2002, and 1.2% in 2003;
- the U.S. civilian unemployment rate remains below the full employment rate of 5.5%;
- consumer confidence peaks in 2000, then slowly tapers off over the forecast period;
- consumer inflation remains tame;
- the federal budget surplus rises to nearly \$265 billion in 2003;
- and the U.S. merchandise trade deficit widens.

While the baseline scenario represents the most likely path for the national economy over the next few years, uncertainties surrounding several key variables mean other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their impacts on the Idaho economy, are discussed below.

While it is believed that the U.S. economy will not suffer a recession over the forecast period, it should be noted that the risk of a recession is high. A review of the probabilities of occurrence for each forecast scenario shows this. The baseline does not include a recession and the probability of occurrence is 55%. However, both of the alternative scenarios do contain recessions and their combined probability of occurrence is 45%. This implies the chances of the economy not suffering a recession over the next few years are barely better than even.

### PESSIMISTIC SCENARIO

The *Pessimistic Scenario* has been assigned a 10% probability of occurrence. This scenario explores the impact a stock market crash would have on the economy. A major correction is a concern because the nation's stock market is severely overvalued by almost every measure. For example, according to DRI, it is 30% to 40% higher than can reasonably be expected. A correction of this magnitude might push the economy into a recession. Another concern is rising oil prices. They have played havoc with the economies of emerging countries, and could pull them into recessions. If U.S. stock markets drop at the same time, carrying foreign markets down with them, a renewed Asian crisis is probable. U.S. consumers are likely to retrench when the stock markets collapse, causing the wealth effect to run in reverse. The result would be a three-quarters long recession that starts in the last quarter of this year.

The good news is that such a recession would likely be relatively mild. Specifically, it would last only three-quarters and decline just 1.3% from peak to trough. To put this in perspective, since 1920, the recessions have lasted an average of about 14 months and experienced an average drop of 6.6% from peak to trough. The recession should be mild because with no inflation the Federal Reserve has the room to react quickly. As the central bank lowers interest rates, investment and housing revive. The recovery picks up steam slowly, however, because the heavy consumer debt burden restricts new spending.

Idaho's economy would suffer a noticeable setback in 2001 under this scenario. Weighed down by that year's national recession, nonfarm employment would expand an anemic 1.1%. This is about half the

**IDAHO ECONOMIC FORECAST**  
**BASELINE AND ALTERNATIVE FORECASTS**  
**JULY 2000**

	BASELINE				PESSIMISTIC				LATE RECESSION			
	2000	2001	2002	2003	2000	2001	2002	2003	2000	2001	2002	2003
<b>GDP (BILLIONS)</b>												
Current \$	9,908	10,395	10,916	11,523	9,878	10,067	10,606	11,248	9,923	10,541	10,871	11,286
% Ch	7.0%	4.9%	5.0%	5.6%	6.7%	1.9%	5.4%	6.1%	7.2%	6.2%	3.1%	3.8%
1992 Chain-Weighted	8,523	8,778	9,053	9,365	8,492	8,467	8,737	9,095	8,534	8,826	8,813	8,931
% Ch	4.9%	3.0%	3.1%	3.5%	4.5%	-0.3%	3.2%	4.1%	5.0%	3.4%	-0.2%	1.3%
<b>PERSONAL INCOME - CURR \$</b>												
Idaho (Millions)	31,482	33,438	35,431	37,557	31,463	33,146	35,167	37,231	31,509	33,692	35,664	37,384
% Ch	7.3%	6.2%	6.0%	6.0%	7.2%	5.3%	6.1%	5.9%	7.4%	6.9%	5.9%	4.8%
U.S. (Billions)	8,282	8,780	9,242	9,740	8,274	8,630	9,044	9,523	8,291	8,877	9,338	9,643
% Ch	6.3%	6.0%	5.3%	5.4%	6.2%	4.3%	4.8%	5.3%	6.4%	7.1%	5.2%	3.3%
<b>PERSONAL INCOME - 1992 \$</b>												
Idaho (Millions)	26,919	28,035	29,021	30,020	26,874	27,659	28,597	29,574	26,901	27,826	28,325	29,128
% Ch	4.7%	4.1%	3.5%	3.4%	4.5%	2.9%	3.4%	3.4%	4.6%	3.4%	1.8%	2.8%
U.S. (Billions)	7,085	7,366	7,575	7,791	7,071	7,207	7,360	7,570	7,082	7,337	7,422	7,520
% Ch	3.8%	4.0%	2.8%	2.8%	3.6%	1.9%	2.1%	2.9%	3.7%	3.6%	1.2%	1.3%
<b>TOTAL NONFARM EMPLOYMENT</b>												
Idaho (Thousands)	558.7	571.7	585.7	599.9	558.2	564.6	576.7	592.0	558.8	571.2	577.2	582.3
% Ch	3.6%	2.3%	2.4%	2.4%	3.5%	1.1%	2.1%	2.7%	3.6%	2.2%	1.0%	0.9%
U.S. (Millions)	131.7	133.7	135.0	136.6	131.6	130.7	130.8	132.7	131.8	134.3	133.9	131.9
% Ch	2.3%	1.5%	1.0%	1.2%	2.2%	-0.6%	0.1%	1.4%	2.3%	1.9%	-0.3%	-1.5%
<b>GOODS PRODUCING SECTOR</b>												
Idaho (Thousands)	117.6	119.4	121.2	123.6	117.3	115.5	117.5	121.1	117.8	120.5	119.4	118.0
% Ch	3.6%	1.5%	1.6%	2.0%	3.3%	-1.6%	1.8%	3.0%	3.7%	2.3%	-0.9%	-1.1%
U.S. (Millions)	25.6	25.3	24.7	24.4	25.6	24.5	23.7	23.6	25.7	25.5	24.6	23.4
% Ch	0.6%	-1.4%	-2.1%	-1.3%	0.4%	-4.4%	-3.0%	-0.5%	0.7%	-0.5%	-3.5%	-5.0%
<b>SERVICE PRODUCING SECTOR</b>												
Idaho (Thousands)	441.1	452.3	464.5	476.3	440.9	449.1	459.2	470.9	441.0	450.8	457.8	464.3
% Ch	3.6%	2.6%	2.7%	2.5%	3.6%	1.9%	2.2%	2.6%	3.6%	2.2%	1.5%	1.3%
U.S. (Millions)	106.1	108.4	110.3	112.2	106.0	106.3	107.1	109.1	106.1	108.8	109.2	108.5
% Ch	2.7%	2.2%	1.7%	1.7%	2.6%	0.3%	0.8%	1.8%	2.8%	2.5%	0.4%	-0.7%
<b>FINANCIAL MARKETS</b>												
Federal Funds Rate	6.4%	6.8%	6.5%	6.1%	6.4%	6.4%	5.2%	4.2%	6.4%	7.4%	7.0%	3.9%
Bank Prime Rate	9.4%	9.8%	9.5%	9.1%	9.4%	9.4%	8.2%	7.2%	9.4%	10.3%	10.3%	7.0%
Mort Rate, New Homes	8.0%	8.4%	8.2%	7.9%	8.1%	8.7%	8.2%	7.5%	8.0%	8.4%	9.1%	7.9%
<b>INFLATION</b>												
GDP Price Deflator	2.1%	1.9%	1.8%	2.0%	2.2%	2.2%	2.1%	1.9%	2.2%	2.8%	3.3%	2.4%
Personal Cons Deflator	2.5%	2.0%	2.4%	2.5%	2.6%	2.4%	2.6%	2.4%	2.6%	3.4%	4.0%	1.9%
Consumer Price Index	3.2%	2.4%	2.5%	2.6%	3.3%	2.7%	2.6%	2.5%	3.4%	4.0%	4.3%	1.8%

Forecast Begins the **FIRST** Quarter of 2000

pace predicted in the baseline case. The goods-producing sector would take the biggest hit; declining 1.6% in 2001. In this same year, the services would eke out just 1.9% growth. Idaho real personal income, which is predicted to expand a healthy 4.1% in 2001 in the baseline case, rises just 2.9% in this scenario. Idaho economic growth does pick up speed in the latter years of the forecast, but not enough to recover lost ground. In 2003, nonfarm employment is about 8,000 lower than in the baseline and real personal income is down by about \$450 million.

## **LATE-RECESSION SCENARIO**

The *Late-Recession Scenario* has been assigned a 35% probability of occurrence. The more likely of the two alternative scenarios considered here, it also contains the more severe downturn. It is also the more traditional one. Every postwar expansion has ended with rising inflation leading to a Federal Reserve overreaction. The higher interest rates, usually helped by an external or fiscal policy shock, then cause a recession. It is such an overreaction that it would end the current record-setting expansion. The risk of higher inflation is already in place. Employer costs have been rising due to the tight labor market. In addition, rising energy prices are also fanning inflation fires. In this scenario, the inflation rate hits 4.0% by late 2001. In an effort to contain inflation, the Federal Reserve jerks the federal funds rate above 8.0% in early 2002. In response to higher interest rates, the stock market corrects sharply. Consumers' wealth disappears and their borrowing costs start to rise. This retards both consumer spending and housing growth, and the economy falls into a recession.

Although it is more severe than the downturn in the Early Recession Scenario, this alternative's recession is mild compared to typical recessions. The economy would recover quickly once the Federal Reserve begins cutting interest rates. The Federal Reserve would be able to loosen aggressively because internal imbalances are relatively minor compared with other postwar recessions. In general, long expansions have been followed by short recessions. This scenario's downturn is not an exception. It starts in the first quarter of 2002 and lasts through its fourth quarter. Real output drops 2.2% from peak to trough.

In this scenario, Idaho's economy manages to keep pace with its baseline counterpart through most of next year. However, it reels off track in the last two years of the forecast. In 2001, Idaho nonfarm employment averages 571,200, which is just 500 lower than in the baseline case. Idaho real personal income in this scenario is \$27.8 billion in 2001, almost a quarter of a million dollars below the baseline projection. Most of this change reflects the higher inflation anticipated in this scenario. The national recession causes the *Late Recession Scenario* to diverge from the baseline in the latter years of the forecast horizon. Weak growth in both 2002 and 2003 cause employment to be more than 17,000 lower in 2003 compared to the baseline case. Idaho real personal income is \$29.1 billion, which is almost a billion dollars short of the baseline's forecast of \$30.0 billion.